No. 85-305

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

MICHAEL E. FRYZEL, Director,
Department of Financial Institutions,

Petitioner,

vs.

CASH CURRENCY EXCHANGE, INC., et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the decision of the United States Court of Appeals for the Seventh Circuit ordering the administrative receiver who was vested with title to and control over the assets of 33 community currency exchanges pursuant to the Illinois Community Currency Exchange Act, Ill. Rev. Stat. ch. 17, §4801 *et seq.* to turn over said assets to the bankruptcy trustee constitutes an unwarranted interference by the federal bankruptcy courts with the State of Illinois' regulation and liquidation of community currency exchanges as enacted by the Illinois legislature in the aforementioned Act.

2. Whether the Seventh Circuit's holding that the administrative receiver duly appointed by the Illinois Director of Financial Institutions is a "custodian" within the meaning of Section 101(10) of the Bankruptcy Code, 11 U.S.C. §101(10), is incorrect and constitutes a violation of the separation of powers doctrine in that the Illinois legislature has committed the control over the regulation and liquidation of community currency exchanges to the Department of Financial Institutions and the federal bankruptcy court thus may not substitute its trustee to interfere with the state proceedings.

PARTIES

The Respondents in this Petition, as set forth in the caption as "CASH CURRENCY EXCHANGE, INC., *et al.*" include DONALD C. SHINE, RECEIVER; the 33 debtor community currency exchanges located in Illinois: 59TH & HALSTED CURRENCY EXCHANGE, INC., PULASKI JACKSON CURRENCY EXCHANGE, INC., DIVISION DAMEN CURRENCY EXCHANGE, INC., LAKE LARAMIE CURRENCY EXCHANGE, INC., 147TH & LOOMIS CURRENCY EXCHANGE, INC., NORTH HALSTED CURRENCY EXCHANGE, INC., CICERO CHICAGO CURRENCY EXCHANGE, INC., OGDEN KEDZIE CURRENCY EXCHANGE, INC., ROOSEVELT AUSTIN CURRENCY EXCHANGE, INC., LAKE PULASKI CURRENCY EXCHANGE, INC., CHICAGO CENTRAL CURRENCY EXCHANGE, INC., ZENITH CURRENCY EXCHANGE, INC., BELMONT KIMBALL CURRENCY EXCHANGE, INC., KEDZIE CARROLL CURRENCY EXCHANGE, INC., BROADWAY LAWRENCE CURRENCY EXCHANGE, INC., 79TH & EXCHANGE CURRENCY EXCHANGE, INC., JACKSON HOMAN CURRENCY EXCHANGE, INC., 51ST & ASHLAND CURRENCY EXCHANGE, INC., 85TH & BURLEY CURRENCY EXCHANGE, INC., 69TH & ASHLAND CURRENCY EXCHANGE, INC., LARAMIE LAKE CURRENCY EXCHANGE, INC., MADISON CALIFORNIA CURRENCY EXCHANGE, INC., MADISON OAK PARK CURRENCY EXCHANGE, INC., ASHLAND GRAND CURRENCY EXCHANGE, INC., MADISON DAMEN CURRENCY EXCHANGE, INC., CENTRAL DIVISION CURRENCY EXCHANGE, INC., ROOSEVELT DAMEN CURRENCY EXCHANGE, INC., CICERO ARMITAGE CURRENCY EXCHANGE, INC., 51ST & HALSTED CURRENCY EXCHANGE, INC., CHICAGO CLARK CURRENCY EXCHANGE, INC., MILWAUKEE CLARK CURRENCY EXCHANGE, INC., 43RD & COTTAGE GROVE CURRENCY EXCHANGE, INC., and BREMENTOWNE CURRENCY EXCHANGE, INC.; TRAVELERS' EXPRESS CO., and UNSECURED CREDITORS' COMMITTEE.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit was entered on May 21, 1985 and has not yet been reported. It is reprinted herein at Appendix A. The opinion of the United States District Court for the Northern District of Illinois is reported at 37 B.R. 617 (D.C. 1984). It is reprinted herein as Appendix B.

JURISDICTION

The decision of the United States Court of Appeals for the Seventh Circuit was entered on May 21, 1985. No petition for rehearing was filed. This petition for a Writ of Certiorari is timely filed within 90 days of that date. Jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

(The text of these provisions are reprinted herein as Appendix C).

Federal Laws

11 U.S.C. §101(10)
11 U.S.C. §109(b)(2)
11 U.S.C. §362(b)(4)
11 U.S.C. §543

State Laws

Ill. Rev. Stat. ch. 17, §4801 *et seq.*

STATEMENT OF THE CASE

The State Law:

The Illinois Community Currency Exchange Act, Ill. Rev. Stat., ch. 17, §4801 *et seq.* regulates the operation of community currency exchanges in Illinois. Section 4802 of the Act defines "Community currency exchange" as

> Community currency exchange means any person, firm, association, partnership or corporation, except an ambulatory currency exchange as hereinafter defined, banks incorporated under the laws of this State and National Banks organized pursuant to the laws of the United States, engaged in the business or service of, and providing facilities for, cashing checks, drafts, money orders or any other evidences of money acceptable to such community currency exchange, for a fee or service charge or other consideration, or engaged in the business of selling or issuing money orders under his or their or its name, or any other money orders (other than United States Post Office money orders, Postal Telegraph Company money orders, or Western Union Telegraph Company money orders), or engaged in both such businesses, or engaged in performing any one or more of the foregoing services.

The public policy behind the Act is set forth in §4809 as being that:

> The General Assembly finds and declares that community currency exchanges provide important and vital services to Illinois citizens, that the number of community currency exchanges should be limited in accordance with the needs of the communities they are to serve, and that it is in the public interest to promote and foster the community currency exchange business and to insure the financial stability thereof.

The Act sets forth administrative receivership and liquidation procedures regarding the exchanges at §§4825-4831, with §4825 stating, in part, as follows:

> If the Director determines that any licensee is insolvent or is violating this Act, he shall appoint a receiver, who shall, under his direction, for the purpose of receivership, take possession of and title to the books, records and assets of every description of the community currency exchange . . .

The Act further provides that until possession of a currency exchange is returned to the licensee or a liquidation proceeding is completed, the Illinois Director of Financial Institutions or the Receiver controls the exchanges' assets and the Receiver may operate the exchanges. §§4825-4826.

Creation of Administrative Receivership

On or about January 31, 1983, 33 community currency exchanges located in Illinois were placed under administrative receiverships pursuant to the Illinois Community Currency Exchange Act, Ill. Rev. Stat., ch. 17, §§4801-4852 (1983) (hereinafter the "Act"). This action was taken by Michael E. Fryzel, Director of the Illinois Department of Financial Institutions, (hereinafter the "Director") after an examination of the books and records of these exchanges by the Department revealed that the liquid funds of all of the 33 exchanges were substantially impaired in violation of Section 7 of the Act (B.Tr. 2/11/83, pp. 10, 26).*

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* To facilitate citation to the record, "Record Item" is abbreviated as "R." and the Record from the bankruptcy court is abbreviated as "R.1-1," etc. Transcript of Proceedings from the bankruptcy court is abbreviated as "B.Tr." and from the district court as "D.Tr."

During the subsequent ten-day period, Donald C. Shine, the Receiver appointed by Director Fryzel, took control over the exchanges—conducting audits, remedying security problems, establishing new bank accounts, and reestablishing service operations. Each of the 33 exchanges was reopened to the public within 48 hours after being initially closed (R. 22; Affidavit of Donald C. Shine).

Initiation of Bankruptcy Proceedings

On February 10, 1983, the thirty-three currency exchange corporations filed voluntary petitions for reorganization in the United States Bankruptcy Court for the Northern District of Illinois under 28 U.S.C. §1334 pursuant to the Bankruptcy Reform Act of 1978, 11 U.S.C. Sections 101 *et seq.* (1979). These filings were not authorized by Director Fryzel nor by Receiver Shine, who had been vested in title to the assets of the 33 exchanges pursuant to Section 15.1 of the Act.

After filing the Chapter 11 petitions, the 33 exchanges located in Illinois presented an application on February 11, 1983 in the Bankruptcy Court seeking an order requiring the Director's receiver to turn over the exchanges' property to the bankruptcy trustee (Supp. to Record). The Director sought and was granted leave on February 18, 1983 to intervene in the adversary turnover proceeding and the Chapter 11 proceeding, although on a limited basis (R. 1-71).

The Director then moved to dismiss the application and the 33 Chapter 11 petitions (R. 1-75, 76). Both motions were denied in separate orders dated February 18, 1983 (R. 1-77). The Bankruptcy Court subsequently ordered the appointment of Mr. Shine as bankruptcy trustee and ordered the Director's receiver to turn over the assets of the 33 exchanges to the trustee.

Appeal to the U.S. District Court

The Director appealed to the U.S. District Court for the Northern District of Illinois under 28 U.S.C. §1334(b) from six Bankruptcy Court orders dated February 18, 1983 as follows (the first three orders were entered in the Chapter 11 proceedings; the other three orders were entered in the turnover proceeding):

> (1) the order granting limited intervention rights to the Director; (2) the order denying the Director's motion to dismiss the chapter 11 petitions or, in the alternative, to abstain; (3) the order appointing a bankruptcy trustee; (4) the order granting limited intervention rights to the Director; (5) the order denying the Director's motion to strike and dismiss the turnover proceedings; and (6) the order requiring the Director's receiver to turn over the exchanges' property to the bankruptcy trustee.

On appeal to the District Court, the Director argued that the community currency exchanges may not be debtors under the Bankruptcy Code since the exchanges are public financial institutions which are regulated by the State of Illinois in a manner closely analogous to that of other financial institutions excluded from being debtors in bankruptcy by their listing in Section 109(b)(2) of the Bankruptcy Code. 11 U.S.C. §109(b)(2) (1985). Specifically, the Director argued that, applying the "state classification" test set forth in *First American Bank & Trust Co. v. George*, 540 F.2d 343, 349 (8th Cir.), *cert. denied*, 429 U.S. 1011 (1976), the exchanges are subject to extensive regulation by the State, they are subject to express statutory procedures for liquidation, and the nature of their business is public or quasi-public and involves interests other than those of the creditors.

The Director further contended that the administrative receiver Shine, appointed under Ill. Rev. Stat. ch. 17,

§4825 (1983), was vested with possession and exclusive title to the assets of the 33 exchanges upon his appointment by the Director, thus the Bankruptcy Court's appointment of a bankruptcy trustee and its Order requiring that the receiver turn over the property pursuant to 11 U.S.C. §543 constituted "an improper interference with the State of Illinois' police and regulatory powers over currency exchanges." Director District Court Brief at 12.

The Director further contended that the Bankruptcy Court did not have power to stay the state proceedings pursuant to 11 U.S.C. §362(b)(4) since the state proceeding brought pursuant to Ill. Rev. Stat. ch. 17, §4825 constituted "an action or proceeding by a governmental unit's police or regulatory power" and that the U.S. Bankruptcy Court should abstain from hearing the Chapter 11 petitions.

The U.S. District Court for the Northern District of Illinois on appeal, while recognizing that the community currency exchanges were public or quasi-public in nature, determined that the regulatory or liquidation procedures of Illinois relating to community currency exchanges did not vindicate the public interest but rather the rights of creditors, and also rejected the Director's argument that the exchanges should be excluded from being debtors under the Bankruptcy Code. The District Court emphasized in its affirmance the currency exchanges' inability to perform the "essential attributes" of a banking institution—accepting deposits and loaning money (District Court Op. at B-9 and B-10).

Seventh Circuit Court of Appeals

The Director appealed the rulings of the District Court to the U.S. Court of Appeals for the Seventh Circuit

under 28 U.S.C. §1293(b). The Director reiterated his arguments made on appeal before the District Court, adding that the District Court erred in holding that the administrative receiver is a custodian under Section 101(10) of the Bankruptcy Code.

The Seventh Circuit held that the three orders entered in the context of the Chapter 11 proceeding were not appealable at that time and affirmed the District Court regarding the three orders entered in the context of the turnover proceedings.

REASONS FOR ALLOWING THE WRIT

INTRODUCTION

The pivotal question posed by this case is whether the Seventh Circuit erroneously affirmed the affirmance by the District Court of the orders of the Bankruptcy Court requiring the Receiver appointed by the Illinois Director of Financial Institutions to turn over the assets of the 33 currency exchanges to the Bankruptcy Trustee. Or, since Donald Shine was both Receiver and Trustee, in essence the question becomes whether the Seventh Circuit properly required Mr. Shine as a trustee to report to a federal bankruptcy judge instead of being responsible as a receiver only to the state regulatory authorities created by an enactment of the Illinois legislature. The State submits that this result is improper and review by this Court is warranted for two reasons:

I.

THE SEVENTH CIRCUIT'S DECISION ORDERING THE RECEIVER WHO WAS VESTED WITH TITLE TO AND CONTROL OVER THE ASSETS OF THE 33 COMMUNITY CURRENCY EXCHANGES PURSUANT TO THE ILLINOIS COMMUNITY CURRENCY EXCHANGE ACT, ILL. REV. STAT., CH. 17, § 4801 *ET SEQ.*, TO TURN OVER SAID ASSETS TO THE BANKRUPTCY TRUSTEE CONSTITUTES AN UNWARRANTED INTERFERENCE BY THE FEDERAL BANKRUPTCY COURTS WITH ILLINOIS' REGULATION AND LIQUIDATION OF COMMUNITY CURRENCY EXCHANGES AS ENACTED BY THE ILLINOIS LEGISLATURE IN ITS PASSAGE OF ILL. REV. STAT. CH. 17, §4801 *ET SEQ.*

Community currency exchanges, often referred to as "poor man's banks", perform invaluable financial functions at their over-six hundred locations in Illinois for the downtrodden of society who cannot afford to utilize banks, especially in light of the current practice of most banks to charge customers for each check and to require minimum balances in checking accounts. What the Seventh Circuit failed to realize in concluding that currency exchanges do not constitute the "substantial equivalent" of a bank, Seventh Circuit Op. at A-12, is that community currency exchanges fill more of a vital public service function in meeting the everyday financial needs of its customers, regardless of whether they are empowered to receive deposits or loan money, than do the more traditional banks for their public customers.

As acknowledged by the Seventh Circuit, no previous cases have ruled on whether currency exchanges constitute the equivalent of banking institutions under the "state classification test" and thus should be excluded as debtors under the Bankruptcy Code, and it is crucial that this Court provide insight as to the true nature of serv-

ices provided by the community currency exchanges in order to ensure that the state regulation of such exchanges in the public interest not be unnecessarily usurped by the operation of the bankruptcy proceedings at greater expense for solely the interest of creditors. In this vein, it is important for this Court to also recognize the need to give priority to state regulation of currency exchanges over bankruptcy relief in order to protect the public interest as opposed to merely that of the creditors.

The community currency exchanges not only cash their customers' meager paychecks to provide them with their subsistence-level funds but also proceed to sell money orders to those customers which are utilized in lieu of checks to pay their rent and utility bills. The currency exchanges in Illinois are the distribution centers for food stamps and also for aid checks, which are delivered directly to the exchanges in order to safeguard their proper receipt. These exchanges thus perform a multitude of financial services for the poor.

It is essential for the protection of the public that these institutions be adequately regulated under the police powers of the State to assure that the moneys handled are adequately received and disbursed. For instance, since the money paid by the customer for the money orders is not due to the payee until it goes through the banking chain of collection, public funds known as "the float" are at risk. Were these funds not to be available upon demand, a crisis would ensue which could have a dire impact on the ability of the poor to be able to effectuate the simplest financial transactions—a void which modern-day banks will likely not choose to fill.

However, the Illinois legislature has chosen to protect its citizens from such pitfalls by enacting a comprehensive set of regulations regarding community currency ex-

changes more extensive than those of any other state. An essential aspect of these regulations are the liquidation procedures set forth in Sections 4825-4830 of Chapter 17 of the Illinois Revised Statutes which provide that the Director may appoint a receiver to handle claims against an exchange if the Director determines that possession should be turned over to the licensee or that the business should be liquidated. The effectiveness of such procedures in protecting the public interest is illustrated by the fact that no public funds have ever been lost since the Illinois currency exchanges first became regulated in 1943.

The vital need for the State of Illinois to regulate the currency exchanges in the public interest because of the nature of the financial services provided by the exchanges was recognized by the Illinois Supreme Court in *McDougall v. Lueder*, 389 Ill. 141, 58 N.E.2d 899 (1945). In *McDougall*, while the Court upheld the prohibition of currency exchanges from accepting deposits, it also upheld, over due process objections, the regulation of currency exchanges, stating as follows (389 Ill. at 149-150):

> Any business conducted primarily or entirely by accepting funds of other people, undertaking to keep the funds intact for an indefinite length of time and the purchasing of paper, such as cashing checks or money orders, is *one in which the public deserves more protection than only the judgment, skill and good luck of the proprietor to protect it against loss.* The opportunities for loss through embezzlements, larceny, the unauthorized use of funds, including bankruptcy through the mishandling of funds, is obvious. *Reasonable regulation thereof falls within the powers of the legislature in the interests of the public safety.* (emphasis added)

The existence of an elaborate scheme of liquidation set up by a state to regulate a trust company was held by the Fifth Circuit to preclude the intervention of bankruptcy proceedings in *Woolsey v. Security Trust Co.*, 74 F.2d 334 (5th Cir. 1935), recognized by the Seventh Circuit at A-17 but not followed. In *Woolsey*, the Court interpreted section 109(b) of the Bankruptcy Code as excluding trust companies as debtors (though trust companies, like community currency exchanges, were not specifically excluded in Section 109(b)), stating as follows (74 F.2d at 337):

> It was considered that *it would be a ruinous thing to the state, to the depositors, and to the creditors to have the elaborate scheme of liquidation which the state provides broken into and nullified by bankruptcy proceedings*, and it was intended, by withdrawing jurisdiction over these corporations from the bankruptcy court, that this would not occur. (emphasis added)

The State of Illinois agrees with the principles set forth by the Fifth Circuit in *Woolsey* and urges this Court to hold that "community currency exchanges" do not constitute debtors under the Bankruptcy Code and to reverse the decision of the Seventh Circuit requiring the administrative receiver to turn over the assets of the 33 exchanges to the bankruptcy trustee.

II.

THE SEVENTH CIRCUIT'S HOLDING THAT THE ADMINISTRATIVE RECEIVER DULY APPOINTED BY THE ILLINOIS DIRECTOR OF FINANCIAL INSTITUTIONS IS A "CUSTODIAN" WITHIN THE MEANING OF SECTION 101(10) OF THE BANKRUPTCY CODE, 11 U.S.C. §101(10), IS INCORRECT AND CONSTITUTES A VIOLATION OF THE SEPARATION OF POWERS DOCTRINE IN THAT THE ILLINOIS LEGISLATURE HAS COMMITTED CONTROL OVER THE REGULATION AND LIQUIDATION OF COMMUNITY CURRENCY EXCHANGES TO THE DEPARTMENT OF FINANCIAL INSTITUTIONS AND THE FEDERAL BANKRUPTCY COURTS THUS MAY NOT SUBSTITUTE ITS OWN TRUSTEE TO INTERFERE WITH THE STATE PROCEEDINGS.

While the Seventh Circuit recognized that "under Illinois law, administrative receivers have exclusive custody of and title to all assets of the entity placed under receivership, including causes of action," Seventh Circuit Op. at A-18, the Court went on to erroneously reject the argument of the Director that the term "custodian" encompassed only court-appointed receivers and not administrative receivers. Seventh Circuit Op. at A-21.

A "custodian" is defined in Section 101(10) of the Bankruptcy Code, 11 U.S.C. §101(10) (1979) as including a(n)

> (A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;
>
> (B) assignee under a general assignment for the benefit of the debtor's creditors; or
>
> (C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

Even though the legislative history suggests that the definition of "custodian" was descriptive rather than exhaustive, an examination of the cited legislative history, S.Rep. No. 989, 95th Cong. 2nd Sess 23 (1978), reveals that the definition is exhaustive only in that it not only encompasses certain specified receivers or trustees but also other *officers of the court* (emphasis added). See Seventh Circuit Op. at A-21.

Since the Receiver appointed by the Director this is not within the category of "custodian" as defined in Section 101.10 of the Bankruptcy Code, 11 U.S.C. §101.10 (1979), the substitution of a bankruptcy trustee by the Bankruptcy Court in place of an administrative receiver who had already taken legal custody and title to all of the assets of the entity under receivership was clearly improper and violative of the separation of powers clause as well as being an unwarranted federal interference into state regulatory processes. While it may be generally true, as noted by the District Court at B-18, that "a corporation cannot be prevented by state statute from taking advantage of bankruptcy law," the situation is distinguishable where, as in the case at bar, the 33 currency exchanges are not mere corporations but are financial institutions whose recognition and continued existence is traceable to the Community Currency Exchange Act. Ill. Rev. Stat. ch. 17, §4801 *et seq.* (1983).

In so holding that the Receiver was a "custodian" and thus the assets of the exchanges could properly be deemed property of the debtor for purposes of turnover pursuant to section 343 of the Bankruptcy Code, the Seventh Circuit ignored the holding of the Second Circuit in *Israel-British Bank (London) Ltd. v. Fed. Dep. Ins. Corp.*, 536 F.2d 509 (2nd Cir. 1976). The Second Circuit in *Israel-British Bank* held that in determining which institutions

constituted debtors under the Bankruptcy Act, "the inference is that *considerations of federalism* required that the states be allowed to liquidate as well as to regulate *their own creations*" (536 F.2d at 514) (emphasis added). Such considerations of federalism also require that the state-created processes for the regulation and/or liquidation of the state-licensed community currency exchanges to be exercised by the receiver not be interfered with by the intervention of the federal bankruptcy laws.

The State of Illinois urges this Court to hold that the administrative receiver appointed by the Illinois Director of Financial Institutions is not a "custodian" under the Bankruptcy Code and thus reverse the order requiring the receiver to turn over the assets of the exchange to the trustee.

CONCLUSION

For the foregoing reasons, petitioners respectfully pray that this Court grant their Petition for a Writ of Certiorari.

Respectfully submitted,

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